How Financial Institutions Can Find Organizational Advantage in PMI

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All indicators suggest that M&A will experience a significant rebound in 2021. We expect transformational combinations among financial institutions such as banks, as well as in other sectors such as asset management and data and information services. A batch of new deals announced at the end of 2020 and early 2021 only strengthens our confidence in that prediction.

Still, a surge in M&A deals doesn't mean that all mergers are successful. BCG research covering the past 20 years of public M&A transactions finds that up to 50% of deals fail to

create shareholder value within two years of the deal's announcement. And even successful transactions show a wide disparity in value creation.

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Executives involved in M&A deals confirm as much. While some companies say the acquired entity was a poor fit strategically and others admit they overpaid, nearly half of the reasons that organizations cite for failure involve their approach to post-merger integration (PMI). And our experience tells us that one of the most critical pillars of integration success is the approach to the future organization. This is true across industries, including financial institutions (FI).

For transformational PMI to succeed, therefore, financial institutions must focus on getting the newly combined organization right—not only generating near-term synergies between the businesses but reshaping the organization to deliver the benefits anticipated with the deal. To do so, we recommend they pursue five critical objectives:

- Realign the operating model to support the combined entity's chosen strategy
- Maximize the efficiency and effectiveness of the combined organization
- Supercharge talent management and efforts to boost diversity
- Invigorate the corporate culture and purpose
- Accelerate the transition to new ways of working

REALIGN THE OPERATING MODEL TO SUPPORT THE COMBINED ENTITY'S CHOSEN STRATEGY

One of the primary ways to deliver synergies and boost performance in transformational M&A is by articulating the major choices for the new operating model—and then creating, and following through with, a thoughtful design.

For example, all integrators correctly put considerable focus on delivering workforce savings, which are essential given the level of investor attention paid to cost synergies. However, quickly narrowing the focus to workforce savings alone can lead to missed opportunities.

Instead, financial institutions should first design a clear structure for the newly combined entity—one that will allow them to not only generate cost savings but build enhanced capabilities over time. Even in integrations that seem relatively straightforward, there are often subtle differences between existing operating models that can have a crucial bearing on the effectiveness of the combined organization. In more complex, transformative integrations, these differences can become major stumbling blocks. They must therefore be identified early on and ironed out so that a winning blueprint can be created.

> A transformative integration represents a critical period for any financial institution.

Some of the actions financial institutions can take as they design a new operating model include the following:

Capture the benefits of scale. Organizations can get the most out of the new, larger organization by optimizing the balance between a federal structure with relatively independent lines of business and a centralized structure with shared services and the elimination of shadow functions.

Optimize the go-to-market design. The newly combined entity should make the most of the differences in segmentation between the two businesses, building up any unique

channels and enhancing collaboration across product groups, as well as harmonizing talent management and underlying frontline incentives across the organization.

Maximize the value of digital, data, and analytics. Businesses should evolve the operating model to deliver the advantages of a bionic company—an organization that combines the capabilities of humans and machines to deliver superior customer experiences and relationships, greater productivity, and a higher innovation rate.

Enhance the ability to deliver technology. Organizations should ensure there is agreement between the lines of business and the development groups that create customer-facing technology by examining the roles of the chief investment officers (CIOs) and chief technical officers (CTOs), making individual responsibilities clear and eliminating any overlaps. In this way, the new firm can deliver an aggressive technology roadmap with a good return on investment from platform modernization, cloud migration, the use of cyber technology, and more.

Increase the maturity of risk management. The new organization should meet the more demanding requirements of a larger institution by embedding greater ownership among those on the first line of defense (that is, those creating and selling its products and services); by specifying the relationship between the roles for all three lines of defense (the second and third being centralized compliance staff and internal auditors, respectively); and by building up functions such as risk analytics.

MAXIMIZE THE EFFICIENCY AND EFFECTIVENESS OF THE COMBINED ORGANIZATION

It goes without saying that the integration needs to deliver both cost reductions and an effective organization. Yet approaches to PMI often fail to realize both—and sometimes either—of these aspects. In addition, we often see approaches in which the target company is simply swallowed by the acquirer. While this approach may be pragmatic, in transformative integrations there are frequently opportunities to improve the operating model of the acquiring company itself, taking a fresh look at the entire organization. A few decisive steps can make the difference:

Set ambitious targets with a zero-based budgeting lens. Before organization design begins, financial institutions should quickly establish top-down targets across all groups. There should be precise goals for first-quarter and year-one P&L impact and for the annualized savings once the integration is complete. These goals should be aggressive enough that shareholder expectations are met, including both cost savings and revenue growth.

Financial institutions should look at these targets through multiple lenses, including synergy benchmarks and growth assumptions by function. We also advise using a zero-based-budgeting cost-driver approach to size the future workforce. Established targets should be achievable yet challenging, and they should encourage creative design thinking.

Frontload decisions and planning. Organizations should take a preclosing approach that clearly specifies the savings to be gained by each significant operational milestone. This approach will give management full clarity about how workforce savings will be delivered over time, providing both a checklist that can be used to ensure the timely realization of savings and a clear basis for any trade-off decisions that need to be made.

With a strong preclosing process, a significant amount of planned employee synergies can be delivered by day one. For example, one major financial institution selected and communicated about 95% of management roles preclosing, leading to the delivery of nearly 30% of the workforce savings target within days of the deal's closure. (Note that the remaining gap in workforce savings is dependent upon another series of important steps, such as process harmonization and the migration of technology systems.)

Reinvest selectively. Too often, we see an approach to PMI in which new investments are spread evenly across the company, rather than allocated to areas of highest competitive advantage. In addition, such investment approaches are often kept opaque, without being communicated to the rest of the organization. Yet there are frequently opportunities during the organizational design process to reinvest in roles that enhance certain functions or enable new growth. These opportunities should be looked for and exploited whenever possible—and the process should be communicated clearly to both stakeholders and employees.

Establish clear and consistent baselines. Given the limited ability to share data across firms during the preclosing phase, it is critical to avoid a loss of value through poor baselines and tracking mechanisms. Practical matters—the difficulty in accounting for open roles and pay scales, for example, or a lack of clarity about factors such as contractor spending—can limit the attainment of targeted synergies. Integration leadership should therefore establish firm, easily understood baselines and tracking mechanisms as part of the integration program, and do so as early as possible.

The integration management office (IMO) plays a leading role in the orchestration of the abovementioned steps. Sample responsibilities include developing a set of design principles for the new organization, establishing ambitious targets, facilitating agreement at the steering committee level, and enabling quick decision making and issue resolution. Peer review sessions in which leaders present proposed designs to colleagues also offer a great way to foster better agreement and accountability between functions.

SUPERCHARGE TALENT MANAGEMENT AND EFFORTS TO BOOST DIVERSITY

The impact on talent in transformative M&A should not be overlooked. Such a significant transaction ushers in considerable uncertainty, and employees are bound to wonder what will happen to their roles. A transformation can also create significant opportunities to promote talented leaders, exploit new capabilities, increase the diversity of thought, and enhance the culture of the combined organization. As such, it can become a launching pad for a broader "people agenda" in the newly established firm.

In this context, financial institutions need to manage top talent with care. In our experience, a few steps are crucial to getting this right:

- Quickly provide clarity to leaders about their role in the new organization.
- Carefully identify and select high-potential talent to take on more critical roles.
- Enroll senior management to engage key personnel in the integration process.
- Thoughtfully select a mix of leaders from both companies; this provides a clear signal about the intentions of the combined entity.

In addition to the retention and advancement of top talent, any integration provides an opportunity to endorse diversity, equity, and inclusion (DE&I). New hires and promotions demonstrate the organization's DE&I commitment to both public and private stakeholders.

Best practices include communicating clearly that DE&I is a priority and will be measured by leadership with the same rigor as other priorities; defining diversity criteria across a broad set of dimensions, including gender, race, LGBTQ identity, age, and parental and veteran status; bringing in new, diverse talent from outside; and ensuring there are eye-catching talent decisions that send a clear signal to the rest of the organization about the importance of DE&I.

INVIGORATE THE CORPORATE CULTURE AND PURPOSE

Integrations often provide a unique opportunity to consider and refine two critical anchors of the new organization, namely its purpose and culture. Financial institutions with a clear, authentic purpose tend to have more energized employees, stronger organizational accord, and improved customer loyalty. Conversely, failing to address cultural dissonance and a lack of clarity in purpose between the two organizations can be detrimental to the success of the integration.

Even so, culture and purpose are often addressed only superficially in integrations. Executives may view the culture differences between the merging companies as only slight, but employees don't tend to see it that way. When we surveyed the employees from two companies in a recent integration, in fact, we found key differences in their perceptions of the culture—not only between the separate companies but also between the employee base and executives within each company. Using the integration as a springboard to address these findings provided the new organization with advantages well beyond the integration itself.

Based on our experience over the past decade, companies should take the following actions during the integration process to build a new culture and sense of purpose:

Articulate the desired culture. Gain an understanding of employees' perceptions of their original company culture and the culture across the two companies, identifying similarities and using them to accelerate collaboration and minimize any differences.

Activate new behaviors to make the desired culture a reality. Build leadership capabilities, introduce new leadership behaviors, and reinforce both with innovative leadership routines, such as rotating meeting leadership to empower employees. Then increase the likelihood of success by making the plan public and encouraging peer-to-peer support and experience-sharing.

Embed behaviors to make sure they stick. Harmonize and transform the organization's ways of working to reinforce target behaviors, people development, performance management, and community building, creating rewards that help develop and reinforce new habits.

ACCELERATE THE TRANSITION TO NEW WAYS OF WORKING

Ways of working have been evolving over the past decade toward more agile, empowered teams in remote and flexible work arrangements, and this evolution has been accelerated by the COVID-19 pandemic. Going forward, companies will need to account for this shift in employee expectations and find the winning equation.

Leaders should use the integration process to clarify their vision and then make the practical changes they deem necessary, whether by investing in technology tools that support new ways of working, upskilling employees, or creating new plans for the physical working space. They will need to make critical design decisions and develop integration roadmaps that reflect major work-model priorities. These priorities should include:

- Making agile ways of working possible through clear organizational interfaces and roles
- Meeting changed expectations about in-person work versus remote, and taking into account the impact on the real estate footprint

- Understanding the implications of the chosen location strategy on the organizational structure, guidelines for talent selection, and relocation policies

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A transformative integration represents a critical period for any financial institution. The potential for value creation is significant, as are the opportunity costs. The decisions made—or not made—during the integration process clearly have a direct impact on synergy capture, employee morale and retention, and, ultimately, the long-term success of the deal.

Given these high stakes, any sizeable integration will require a robust, battle-tested playbook that is tailored to the deal's specifics, along with a strong commitment from senior leadership and the effective mobilization of internal resources. Following best practices throughout can tilt the odds in the business's favor, ensuring that the deal maximizes value and positions the organization for future success.

To learn more about post-merger integration in financial institutions, please reach out to the authors below for more information and additional materials.

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